

VZCZCXRO6146
RR RUEHIK
DE RUEHVJ #1419/01 3620717
ZNR UUUUU ZZH
R 280717Z DEC 09
FM AMEMBASSY SARAJEVO
TO RUEHC/SECSTATE WASHDC 1174
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 02 SARAJEVO 001419

SENSITIVE
SIPDIS

STATE FOR EUR/SCE AND EEB/IFD
TREASURY FOR OASIA (PETER MAIER)

E.O. 12958: N/A
TAGS: [EFIN](#) [ECON](#) [PGOV](#) [IMF](#) [SOCI](#) [BK](#)
SUBJECT: BOSNIA: SLIGHT DELAY IN IMF SECOND TRANCHE

REF: SARAJEVO 1299

SARAJEVO 00001419 001.2 OF 002

Summary

1. (SBU) It appears that Bosnia and Herzegovina (BiH) is on track for receiving the next tranche of assistance from the country's IMF Stand-By Arrangement (SBA) in January 2010. However, given political squabbling, particularly as 2010 is an elections year, we will not be surprised by delays as a result of IMF criteria not being addressed in a timely manner. Nevertheless, we understand that the IMF -- which remains optimistic that Bosnian leaders will complete necessary measures for the SBA to remain on track -- will remain flexible in its disbursement schedule. End summary.

The Happy Face

2. (SBU) IMF representatives argue that the Stand-By Arrangement has already had a positive impact in BiH and that BiH State government, the Federation of BiH, and Republika Srpska (RS) have all made progress. They note that the current account deficit is shrinking faster than expected; pressures on the banking sector have eased; and confidence in the banking sector is growing. They point to the plain fact that the first disbursement of the IMF program in July, worth more than USD 180 million, bolstered Central Bank reserves and eased short-term pressure on the Federation and RS budgets. The two entities initially rebalanced their 2009 budgets in August and met the IMF's quantitative targets for September. (Note: Both the RS and FBiH have rebalanced their 2009 budgets several times since to compensate for a decrease in revenues. End Note.)

Three Tougher Goals Remain Unmet

3. (SBU) IMF Resident Representative Milan Cuc recently outlined three remaining conditions for disbursement of the second tranche, worth nearly USD 140 million. First, the State government and two entities must pass 2010 budgets that remain within the limit of a deficit of 4.5 percent of GDP. The RS National Assembly adopted a KM 1.6 billion budget on December 16, with significant cuts in public sector salaries. The Federation adopted a KM 1.7 billion budget on December

23. The state-level budget has historically been the most contentious. Bosniak and Croat members of the BiH Presidency increased the original KM 1.03 billion state budget approved by the Council of Ministers to KM 1.05 billion in November, to increase funding for refugee returnee programs. Following the BiH House of Representatives rejection of the increase, State Finance Minister Dragan Vrankic reintroduced a new

budget that increases the allotment for returnee programs while staying within the KM 1.03 billion envelope. The budget has passed the BiH House of Representatives' first reading on December 23 but is awaiting further Parliamentary consideration expected on December 30. Some RS politicians, however, are threatening to object.

¶4. (SBU) An additional condition for the second disbursement is for the two entities to adopt framework laws establishing social benefit systems based on means testing. This would replace the prevailing system in which overly generous social benefits are allocated on the basis of one's membership in favored groups, including several categories of veterans, regardless of actual need. As a first step toward such a system, the Federation has introduced legislation to authorize an audit of veterans' benefits. Veterans' organizations have supported the idea of an audit, hoping to protect those who need the benefits most, although they do not necessarily agree with the audit's methodology. The Federation House of Representatives, however, narrowly rejected the law on December 8. The Federation reintroduced the legislation the following day, determined to push this through as the essential foundation for reforming the benefits system. The Federation was successful and the law passed on December 22.

¶5. (SBU) The third condition, applicable only to the Federation, required adoption of a law eliminating special unemployment benefits for demobilized soldiers no later than May 1, 2010. The May 1 deadline was the only truly new element to the IMF program. Cuc explained that the original letter of intent had called for elimination of these benefits by January 1. However, Federation authorities asserted that they had understood the January date to be an indicative target rather than a deadline. Cuc told us that the IMF

SARAJEVO 00001419 002.2 OF 002

decided to cut the Federation some slack on the issue, but made it clear that May 1 is a deadline for elimination of these benefits. Additionally, the IMF has made clear that the law setting that deadline is a condition for the second disbursement. The Federation, in turn, has since asserted that they comply with this condition, because the law on demobilized soldiers' benefits expires on May 1, 2010 and will not be renewed. IMF representatives told us that this should satisfy its conditions absent a law.

Setting Fiscal Responsibility in Stone

¶6. (SBU) Cuc noted that these changes will not prevent a future Bosnian government from passing fiscally unsustainable laws. For that reason, the IMF will require establishment of an "organic" budget law as a requirement for future disbursements. Such a law would help to end the ad hoc passage of unfunded benefit packages in the future, by requiring analysis of fiscal impacts of proposed legislation. This is the only remaining Federation issue needed to meet the conditions for the second disbursement. The law was before Parliament on December 22.

Comment

¶7. (SBU) Although some of the measures required under the IMF program are politically difficult, Bosnian policymakers have begun to make a more persuasive case to their voters that they are necessary. In the RS, Prime Minister Milorad Dodik -- usually inclined to assert the fiscal soundness of the RS government -- has recently issued uncharacteristic calls for budget tightening. And in the Federation, Finance Minister Vjekoslav Bevanda has been increasingly willing to make the case publicly that if the Federation doesn't find a way to clean up its system of social benefits and pensions, cuts will have to be made across the board, hitting those who need and deserve such benefits hardest. That message appears

to be having an effect. That said, the state and entity governments are facing such difficult fiscal challenges that they are willing to take extraordinary measures including extra sessions of Parliament to obtain the second tranche of IMF funds before the end of Bosnia's fiscal year. In the upcoming months, we expect veterans' benefits to be a thorn in upcoming disbursement rounds.

ENGLISH